No. 22227

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

HOLLY P. SMITH and LOMA M. SMITH,

Respondents.

On Petition for Review of the Decision of the Tax Court of the United States

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BRIEF FOR THE RESPONDENTS

DANA C. SMITH,
712 First Western Bank Building,
Pasadena, Calif. 91101,
Counsel for Respondents.

Parker & Son, Inc., Law Printers, Los Angeles, Phone MA. 6-9171.

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BRIEF FOR THE RESPONDENTS.

Jurisdiction.

Respondents do not question the jurisdiction of the Court with regard to this Appeal.

Question Presented.

Respondents disagree with Petitioner's statement of the question presented and rephrase it as follows:

Is the owner of a house, which he has permanently abandoned as his home in favor of a new residence elsewhere, to be deprived of deductions for maintenance expenses and depreciation because the owner did not offer the house for rent but only for sale, under the statutory provisions authorizing these deductions in con-

nection with property "held for the production of income"? Secondarily, under the above circumstances, is there any distinction to be drawn which would deprive the owner of the depreciation allowance, even if the maintenance expenses are allowable?

Statutes and Regulations Involved.

The statutes and Regulations involved are those set out by Petitioner in the Appendix in his brief and in addition thereto IRC Sections 165(c); 62(5); and 1034(a), and Regulations Subsections 1.167(b)-0(a); 1.167(b)-1(a); and 1.212-1(b) all set out in the Appendix hereto.

Statement of the Case.

Petitioner, in his "Statement" starting on Page 2 of his brief, paraphrases the Stipulation of Facts with certain variations and omissions. Respondent taxpayers, for their statement of facts, incorporate herein by reference, stipulations 3 through 20 of the Stipulation of Facts starting on Page 16 of the Transcript of the Record, which has been filed herein; and agree that the Tax Court allowed the respondent taxpayers the deductions which are here in issue in connection with the former home of the taxpayers, on the ground that it was held by them for the production of income pursuant to Sections 167(a)(2) and 212(2) of the Internal Revenue Code of 1954. It is respondent taxpayers' position that this decision by the Tax Court was correct.

Summary of Argument.

PART I.
THE CASE FOR THE RESPONDENT TAXPAYERS.

A. The conclusion by the Tax Court that the property in question was held for the production of income during the years in question is a conclusion of fact which this Court will not disturb unless it is "clearly wrong" and not supported by competent evidence.

B. To the extent that an issue of law is involved, the opinion of the Tax Court is to be given substantial respect and weight by this Court because of the special qualifications of the Tax Court in the field of taxation, although it lies within the province of this Court to overrule the Tax Court if this Court is satisfied that the Tax Court applied an erroneous rule of law or misapplied the law to the facts involved.

C. The statutes, authorizing the deductions here in question, are broad in language, and they were intended by Congress as relief statutes so should be liberally interpreted to accomplish the relief which Congress intended, as long as that relief falls within the language used in the statutes involved.

The phrase "held for the production of income" which is used in these statutes, both with regard to the allowance for depreciation and with regard to the allowance of expenses, was intended to equalize the position of taxpayers who merely held property for the production of income, with the position of taxpayers who

were using property actively in a trade or business, and were intended by Congress to be applicable in substantially all cases where income, if realized from such holding, would be taxable. If these taxpayers had sold their former home at a profit, this profit would, of course, have been taxable.

D. The Commissioner's original Regulations undertook to limit expense deductions to cases where the property was rented or otherwise appropriated to income producing purposes by some affirmative act. The Tax Court at one time supported this Regulation, but this language was later withdrawn by Petitioner. No such affirmative act is any longer required by the Regulations or the present ruling cases. Even if the withdrawn language of the Regulations were still in effect, the various actions of these taxpayers, as set out in stipulations 7 through 13 [T. -17], would be ample to meet that requirement.

E. It has been uniformly held that after a taxpayer moves out of a former residence he is entitled to these deductions if he does not intend to reoccupy the property later and offers it for rent. The weight of case authority and the clear language of the statutes and Regulations involved authorizes these allowances where such property is offered for sale, as long as there is clear evidence that the property is no longer held by the taxpayer for any personal, living or family use, even though not offered for rent. It is the taxpayers' position that the offering for rent is merely one item of evidence to be considered by the trial Court (here the Tax Court) in determining the issue of the purpose for which the property was being held and its absence is in no way decisive.

PART II.
DISCUSSION OF PETITIONER'S ARGUMENT.

A. Petitioner seeks to disallow both expenses and depreciation by asserting that expenses incurred in looking after property, which was formerly the taxpayer's home, retain their character as personal expenses because the property was originally the taxpayer's home. This overlooks entirely the distinction clearly drawn in the statutes between property *used* for personal or family purposes and property no longer so used, and which has thus become an asset in the taxpayer's hands, which is solely of economic value to him. Petitioner's claim would as logically apply to a former residence held for rent, as to a former residence held for sale only, so would be entirely contrary to all of the cases cited by the taxpayers in Part I E. hereafter, as well as Petitioner's own position before the Tax Court and in his Petition for Review herein [T. -29].

B. In Part II of his brief, Petitioner seeks to differentiate between the allowance of expenses and the allowance of depreciation on the claim that it was the intention of Congress that depreciation be only allowable where property is actively in use by the taxpayer in an income producing activity, or held for such use, as an offset to receipts from that activity. These taxpayers disagree, as such a concept does violence to the statutory language here involved. The Regulations and cases, to any extent that they may appear to support Petitioner's position, were intended to apply solely to property used in a trade or business, and not to property merely "held" for the production of income. "Held" is a passive word neither implying or requiring any activity beyond what is necessary for the conservation or maintenance of the property.

ARGUMENT.

PART I.

THE CASE ON BEHALF OF THE RESPONDENTS.

A. The Statutory Background and the Findings of the Tax Court.

Prior to the filing of Petitioner's brief in the case at bar, there seems to have been no distinction drawn in any of the cases between the allowance of expenses and the allowance for depreciation; nor, indeed, does the Government seem to have at any time urged upon any Court that there should be such a distinction. The argument in this Part I is, therefore, intended to apply both to the allowance for expenses and the allowance for depreciation.

Internal Revenue Code Section 212(2) states that deductions for expenses are allowable for "the management, conservation or maintenance of property held for the production of income". Section 167(a)(2) allows the deduction of "a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—(2) of property held for the production of income". It is important to note the identical language used in these two sections in stating that their respective deductions are allowable on "property held for the production of income". Both of these provisions first appear, at the same time, in the Revenue Act of 1942. Prior to 1942, the revenue laws contained provisions for such deductions only in connection with property used in a trade or business. In 1942 Congress decided that the earlier law was too restrictive with re-

gard to such deductions and added the above provisions, retroactively. Revenue Act of 1942, Sec. 121(e). The present subsection 212(2) regarding expenses appeared as subsection *23(a)(2)* of the 1939 Code, and the present subsection 167(a)(2) regarding depreciation appeared as subsection 23(1)(2) of the 1939 Code (both as amended in 1942), both in the same language in each Code, so far as the issues in this case are concerned.

In discussing the allowance for expenses, the 1942 House of Representatives Committee Report, appearing at 1942 C.B., part 2, p. 410, states the following:

> "The existing law allows taxpayer to deduct expenses incurred in connection with a trade or business. Due partly to the inadequacy of the statute and partly to court decisions, nontrade or nonbusiness expenses are not deductible, although nontrade or nonbusiness income is fully subject to tax. The bill corrects this inequity by allowing all of the ordinary and necessary expenses paid or incurred for the production or collection of income or for the management, *conservation,* or *maintenance* of property held for the production of income. Thus, whether or not the expense is in connection with the taxpayer's trade or business, if it is expended in the pursuit of income or in connection with property *held* for the production of income, it is allowable." (Emphasis added).

From this language it is entirely clear that Congress had in mind the allowance of the expense deduction, whether or not the taxpayer was in active pursuit

of income from the property or merely holding it in the hope of some future realization of income, with such activities as would be incidental thereto.

"Held does not imply 'used' or 'held for use', as Congress would presumably have used some such language if it had so intended, and the Committee Report above quoted separately covers expenses incurred in the "pursuit" of income, "or in connection with property *held* for the production of income". (Emphasis supplied). There also seems to be no distinction possible between such a holding of property for rental income or for capital gains, as there is no substantial difference between the two uses in the nature or amount of activity required in the conservation or maintenance of the property involved.

This distinction is clearly drawn by the Supreme Court in *Bingham's Trust v. Commissioner,* 325 U.S. 365; 65 S. Ct. 1232; 89 L. Ed. 1670; the Court saying, in the third from last paragraph of its opinion, that deductions are allowable under Section 23 (a)(2), (now Section 212(2)), if "directly connected with or proximately result from the enterprise—the management of property held for the production of income" and need not pertain to the actual production of the income.

As the language used in connection with the allowance of depreciation is identical with that used in the expense provision, and was brought into the law at the same time, it seems clear that it should be given the same meaning. (See *Fagan,* P-H Memo T.C., par. 50,017, and *Mitchell,* 47 T.C. 120 (1966)). Pursuant to the above statutes, the Tax Court here held that

Respondents' property was held for the production of income [T. -25]. It is perfectly clear, from the stipulated facts, that Respondents were holding the property for sale, and for no other purpose, from the time that they abandoned it as their home, and Petitioner does not appear to question this. The Tax Court appears to conclude from this that, factually, the property was not being held for any "personal, living or family" use, but only to obtain income from sale of it. Such a conclusion from the facts stipulated is to be accepted by this Court unless clearly erroneous under FRCP rule 52(a), as applied in the last paragraph of *Achong v. Commissioner,* 246 F. 2d 445, by this Court.

This Court and other Courts have uniformly held in other contexts that the purpose for which a taxpayer is holding property is a question of fact and that the determination of it by the trial court (here the Tax Court) from all of the facts, is not to be disturbed on appeal if supported by substantial evidence. This rule seems equally applicable here. *Stockton Harbor Industrial Co. v. Commissioner,* 216 F. 2d 628 (C.A. 9-1954) issues I and IV. *Heller Trust Company v. Commissioner,* 382 F. 2d 675 (C.A. 9-1957) (Point 1).

Under the above cases, and *Achong v. Commissioner,* (above) it appears that the conclusion of the Tax Court in the case at bar, that Respondents were holding the property for the production of income, is itself a well supported conclusion of fact, and therefore decisive of this case in favor of these taxpayers. See also the later part of the opinion in *McDonald v. Commissioner,* 323 U.S. 57; 65 S. Ct. 96; 89 L. Ed. 68, and the last paragraph of *Duval Motor Co. v. Commissioner,* 264 F. 2d 548 (C.A. 5-1959).

B. The Tax Court's Application of the Law.

The Tax Court, however, stated that a question of law is involved, so it seems desirable that this case be discussed from that standpoint, also. The applicability (to these factual conclusions) of the two last mentioned sections of the Code seems to be what the Tax Court must have considered as the question of law involved. The Tax Court ruled that, as a matter of law, the two sections in question did apply, and entitled the taxpayers to the deductions which they claimed. This conclusion by the Tax Court, as to the law, (if such it be) is, of course, entitled to be given substantial weight by this Court under the rule of *Dobson v. Commissioner,* 320 U.S. 498, 64 S. Ct. 239, 247, 88 L. Ed. 248, where it is held that a decision of the Tax Court should not be reversed unless the reviewing Court can identify a clear-cut mistake of law. See also the latter part of *McDonald v. Commissioner,* (above). These principles have been recognized by this Court in several cases. See *Stockton Harbor Industrial Co. v. Commissioner,* 216 F. 2d 628 (1954) and the last paragraph of *Achong,* (above). Petitioner, in the case at bar, is therefore faced with the considerable burden of demonstrating, to the satisfaction of this Court, that the Tax Court made a clear-cut mistake of law, in determining that property, which was held solely for the purpose of sale, does not come within the scope of the above two sections authorizing deductions in connection with property "held for the production of income".

C. Congressional Intent.

When Congress in 1942 passed the statutory amendments which brought into the law the predecessors to Sections 167(a)(2) and 212(2), they did so for the purpose of equalizing the positions of taxpayers who were holding property for the production of income with taxpayers who were using property in their trade or business, with respect to the allowance of depreciation and expenses. In this connection, the Committee Report of the House of Representatives appearing at 1942 C.B., part 2, p. 410 (quoted in paragraph A. above) is clearly a provision for relief of one class of taxpayers to equalize them with another class, as a matter of public policy. This is further evidenced by Congress' action in making this provision retroactive. This provsion is therefore to be interpreted broadly to accomplish the purpose of Congress, where that purpose is consistent with the language of the statute. *Malat v. Riddell,* 383 U.S. 569; 86 S. Ct. 1030; 16 L. Ed. 2d 102; *United States v. Pleasants,* 305 U.S. 359; 59 S. Ct. 281 (Point 3); 83 L. Ed. 217. The identical language of Section 167(a)(2) allowing depreciation, passed at the same time, and having the same justification, must clearly be given the same interpretation. See *Fagan* and *Mitchell* above.)

The language used, that property need only be held for the production of income, is broad and clearly includes this intent of Congress that there be no requirement that any *current* income be obtainable or even sought. The Supreme Court has held that such expenses, to be allowable, need pertain only to the property so held, and need not be related to the actual production

of any income. See *Bingham's Trust v. Commissioner,* (above) (Point 8).

The use by Congress, in Section 62(5), of the phrase "Property held for the production of rents—" as a limitation on the application of Section 212 and in Section 165(c) of the phrase "—transaction entered into for profit" also indicate that Congress had no intention of limiting the phrase "held for the production of income" to the more restricted situations described in those two subsections.

D. Petitioner's Regulations.

The Petitioner's present Regulations regarding depreciation (Section 1.167(a)(2)) recognizes this purpose and effect of the statutory language. The only exception with regard to improvements on real property which is otherwise subject to depreciation reads as follows: "No deduction for depreciation shall be allowed—on a building used by the taxpayer solely as his residence, or on furniture or furnishings therein, personal effects, or clothing;—". No exception is made for property *formerly* used by the taxpayer as his residence, but no longer so used, and held only in the hope of a possible gain through sale.

The Regulations with regard to expenses are more elaborate. Regulation Section 1.212-1(b) specifically stating that the term "income" as used in Section 212, "is not confined to recurring income, but applies as well to gains from the disposition of property. For example, if defaulted bonds, the interest from which if received would be includible in income, are purchased with the expectation of *realizing capital gain* on their resale, even though no current yield thereon is antici-

pated—" (Emphasis supplied), expenses in connection therewith are allowable. It further states that such expenses are deductible in connection with property held for investment "even though the property is not currently productive and there is no likelihood that the property will be sold at a profit or will otherwise be productive of income and even though the property is held merely to minimize a loss with respect thereto." This is consistent with the holding of the Court of Appeals for the District of Columbia in *Doggett v. Burnett,* 65 F. 2d 191, that even to be a business there need not be any contemplation of a profit. Again in subdivision (h) an exception is made with regard to "property held for use as a residence by the taxpayer", which is substantially identical with the exception above quoted in regard to depreciation, and again is not extended to a taxpayer's *former* residence, no longer held for such use.

This subdivision (h) specifically authorizes deductions in connection with rental property, but nowhere does Section 212 undertake to confine such deductions solely to rental property.

If the statements and examples given in Regulation Subsections 1.212(a) and (h) regarding expenses had been intended to restrict the meaning of "held for the production of income", instead of merely illustrating it, they would also no doubt have been included in subsection 1.167(a)(2) regarding depreciation, as the applicable Code language is, as above noted, the same.

E. Applicable Case Law.

It is long established law that words used in the Revenue laws are to be given their "ordinary, everyday senses" except under such circumstances that some

other meaning must be used to effect the legislative purpose, and the language is not inconsistent with that purpose. *Malat v. Riddell,* (above); *Commissioner v. Korell,* 399 U.S. 619; 70 S. Ct. 905; 94 L. Ed. 546. The extent of the deduction depends on legislative policy of Congress, as "expressed in the fair and natural meaning of Section 23". *Lykes v. United States,* 343 U.S. 118; 72 S. Ct. 585; 96 L. Ed. 791.

It is also long established law that the word "income" includes the gain realized by a single isolated sale of property, as the commonly understood meaning of the term when the income tax law was enacted. *Merchants Loan & Trust Co. v. Smietanka,* 255 U.S. 509; 41 S. Ct. 386; 65 L. Ed. 751. The Court of Appeals for the Fourth Circuit, in *May v. Commissioner,* 299 F. 2d 725 (1962) considered the law to be well established that a taxpayer, under facts such as the case at bar, is entitled to the deductions allowed by the Tax Court.

Thus, the efforts of the Petitioner to restrict the benefits of Sections 167(a)(2) and 212(2) by excluding therefrom property held for possible capital gain, whether or not current income is sought, seems entirely contrary to established law.

This is particularly true of Petitioner's effort, in the case at bar, to exclude the holding of improved real estate when his own regulation gives an example allowing expense deductions in the case of a defaulted bond, held in the hope of ultimate gain on sale, though no current income may be expected, and, indeed, if it is held only in the hope of minimizing a loss. See Regulation 1.212-1(b). Both defaulted bonds and improved real estate are clearly "property".

There are many cases in the Tax Court and elsewhere, which allow deductions such as are here in issue where a former home has been offered for rental, even though never rented. It was the position of the Petitioner in the Tax Court and in his Petition for Review herein, that the sole point at issue in the case at bar is that these deductions should not be allowed because Respondents did not offer their former residence for rent [T. -28, 29], recognizing that an offering for rent would have made these expenses and depreciation deductible. Petitioner's position would have the very undesirable and unfair effect of discriminating between an honest taxpayer offering his property for sale only, and a devious one offering his property also for rent but finding some reasonable sounding excuse to turn down any prospective tenant.

In the Petitioner's original Regulations under the 1942 Act, it was stated that such expenses were not deductible even though efforts were being made to sell prior to the time the property was rented "or otherwise appropriated to income producing purposes". Regulation 103, Sections 19.23(a)-15 (as amended by T.D. 5196). The Tax Court in the case of *Warren Leslie,* 6 T.C. 488, 494 (1946) upheld this requirement of the Regulations for the year 1940 over a vigorous and cogent dissent by Judge Disney in which Judge Leech agreed. This dissenting opinion, starting at Page 495, appears to Petitioner to be the most thorough and penetrating discussion of the allowance of expenses, such as are in issue in the case at bar, that appears in any of the cases which Petitioner has found. After the *Leslie* case, Petitioner, apparently agreeing with Judge Disney's opinion, rewrote the applicable Regu-

lation into its present form, omitting therefrom the language above mentioned requiring that property be rented or otherwise appropriated to income producing purposes before such expenses would be deductible. (Regulation Section 1.212-1(b) and (h)). As pointed out by Judge Disney, the requirement of the statute for the allowance of these expense deductions is met merely by holding the property for the production of income and there is now nothing in the Regulations to the contrary. (Of course, a residence while being occupied as his home by the taxpayer is not entitled to this deduction because Section 262 of the 1954 Code specifically disallows deductions for "personal, living or family expenses".) The *Leslie* case can no longer be considered authority because the ground was cut out from under it by the removal from the Regulations of the language on which it was based. It seems to have been followed on this point in only one case, *Coulter,* 9 T.C. Memo 248 (1950) par. 50,077 P-HT.C. Memo. In *Coulter,* however, the judge based his decision on the ground that there was no rental "to mark the conversion from personal to business use". From this it would appear that the Court completely overlooked the 1942 amendments authorizing such deductions on property held for the production of income, as these amendments are neither mentioned nor discussed, although the years at issue were 1943 and 1944. Obviously, this case cannot be considered authority as to the application of the 1942 amendments.

Other Tax Court cases are mentioned by Petitioner on Page 15 of his brief. It may be unnecessary for this Court to review these Tax Court cases in view of the Tax Court conclusion in the case at bar, under the

rule stated by the Supreme Court in *McDonald v. Commissioner,* 323 U.S. 57; 65 S. Ct. 96; 89 L. Ed. 68; that reviewing courts are not to upset Tax Court decisions by analyzing details of previous Tax Court decisions, under the *Dobson* rule limiting the scope of such review. The following comments on these Tax Court cases, comprising the remainder of this Part I, are offered, if this Court desires, nevertheless, to consider them.

The cases cited by Petitioner are *Melone, Stutz, Neave, Jones, Horrmann, Fagan,* and *Newberry.* Some of these cases disallow deductions for depreciation or expenses, or both, because the property was not offered for rent. None of them, however, goes so far as to say that an offer for rent is the only, or an essential, manner of proving that the property was held for the production of income and in none of them was other convincing evidence mentioned that showed the taxpayer had permanently abandoned his residential intentions with regard to the property in question. In particular, in the *Neave* case (17 T.C. 1237, 1243) the Court specifically points out that neither the Petitioner nor his wife testified, that they did not acquire another permanent home until later and left their furniture in the house until about the time of sale. Clearly, there was absent in this *Neave* case any evidence to indicate that the house had been permanently abandoned as the taxpayers' home, as they could have returned to it at any time during the years in question, as the Tax Court points out, except perhaps during the short period of a temporary summer rental. There would, however, have been no point to the recital by the Court of the above mentioned circumstances if an offering for rent was the only, or an essential, piece of evidence necessary to

entitle the taxpayer to the deductions claimed. (Respondents agree that a temporary rental is not decisive of the issues here involved in either direction).

In its Notice of Appeal herein, and before the Tax Court, Petitioner took the position that the Tax Court decisions mentioned required the conclusion that the property had to be offered for rent to obtain the benefit of the depreciation and expense deductions. This distinction is inherently a very weak one, as a mere offering for rent does not preclude the intent to later resume personal occupancy and depends solely on what the taxpayer *says* he intends to do, as contrasted with such actions as these taxpayers took. (Stipulation of Facts 6 through 12 [T. -16. 17].) It seems that the conclusions to the contrary of at least five judges of the Tax Court should be given conclusive effect as to the rule in that Court, (Petitioner to the contrary notwithstanding), particularly as they are supported by the wholehearted agreement of the learned judges of the Fourth Circuit Court of Appeals in *May v. Commissioner,* (above). The cases where these opinions are expressed are the following:

Robinson, 2 T.C. 305, where Judge Disney, at Page 308, states, "The Petitioner was clearly holding the property for sale—attempting to sell it—so was holding it for production of income for gain from sale." In view of this language, the fact that the property was also offered for rent, and the garage was actually rented briefly (Page 309), must be taken as separate grounds for the decision and not as taking the place of the holding above quoted. The *Leslie* case might be considered as overruling *Robinson,* except that the language of the Regulation on which it was based was

later abandoned by Petitioner and it does not appear in the *Leslie* case that there was any evidence, other than the taxpayer's removal from the premises and the offer for sale, to demonstrate that the character of the property as taxpayer's residence had actually been terminated.

In *Fagan* (P-H Memo TC., par. 50,017), Judge Van Fossan expressly applied the *Robinson* rule to the allowance of depreciation from the time the taxpayer abandoned her residential purpose in holding the house and offered it for sale. He states as follows:

> "In our opinion, a proper interpretation of the term 'property held for the production of income' would lead to the conclusion that this property was so held in 1933 when it was permanently abandoned as a residence and offered for sale. Such would seem to be within our holding in the Robinson case. We so find."

The Court also quotes the portion of the present Regulations allowing expenses where the property is held merely to minimize a loss, and applies this language to the depreciation issue also. Petitioner, at the foot of Page 15 of his brief (number 4), seeks to weaken the *Fagan* case by pointing out that the taxpayer had used the property for residential purposes only occasionally and briefly. Nevertheless, until the property was offered for sale, this was the only action of the taxpayer indicating her purpose in holding the property and it was entirely clear that in building the house the taxpayer intended it to be her personal residence. This intention would, of course, continue to control until the property was offered for sale and the taxpayer abandoned her residential purpose in connection with it.

Such being the case, the fact that her actual occupancy of it was minimal is clearly immaterial.

In *Leslie* (above) Judge Leech joined in Judge Disney's position dissenting from the majority decision, even in the face of the language in the Regulation above referred to as then effective.

In *O'Madigan,* P-H Memo T.C. 1960, par. 60,212 Judge Hanson states that "holding a property for sale was holding it for the production of income" and allowed maintenance expenses as being necessary "in connection with his efforts to *sell* his property." (Emphasis supplied). While it is true that the property was also rented during part of the time that it was offered for sale, the above quoted language makes it clear that Judge Hanson did not consider that circumstance to be essential to the allowance of the deductions. He cites both the *Robinson* case (above discussed) and the *Horrmann* case (17 T.C. 903) as so holding. While the applicable language of the *Horrmann* case (bottom of Page 907 and top of Page 908) is not entirely clear on this subject, it does appear that efforts to rent the property were not made during all of the period in question so the case is certainly subject to the interpretation which Judge Hanson places upon it.

Thus, when Judge Arundell, in the case at bar, squarely holds that this property, held for sale, was therefore held for the production of income and entitled the Respondents to the deductions claimed, he adds the fifth to the judges of the Tax Court so holding. In

addition to the *Robinson* case, he cites the *Mitchell* case just previously decided by him (47 T.C. 120) and the Federal District Court case of *Riley v. U.S.,* 189 F. Supp. 510, 513, 514. In the *Riley* case the Court approved and followed *Robinson* (above) allowing deductions in connection with an "own your own" apartment while offered for sale, and before it was offered for rent. That taxpayer had moved into a house which he had purchased and moved all his personal property out of the apartment, thus evidencing the termination of the status of the apartment as taxpayer's residence. In the *Riley* case, the Tax Court cases above mentioned and others referred to by the Government in its brief in the case at bar, are discussed to the same effect as hereinabove urged on behalf of these taxpayers.

In the case of *May v. Commissioner,* 299 F. 2d 725 (1962) three judges of the Court of Appeals for the Fourth Circuit gave their thorough going approval to the Tax Court decision in *Fagan* (above). The *May* decision states "—the tax law recognizes that certain kinds of property held for sale without more may qualify for the deductions,". Citing *Fagan* and *Newberry* (below). Again, "In regard to nonbusiness properties unrented or withdrawn from rent, these statutes disclose an intent to allow deduction of expenses and depreciation only on buildings and similar holdings." Further on the Court states, "When property has the unique qualities of a pleasure boat, even stouter evidence of conversion is demanded than is requisite in the absence of such unicity. In contrast, a building

such as a residence changes its character as readily as its owner takes up other abode, since for that purpose he cannot at whim return." True, this language of the Fourth Circuit appears in a case distinguishing between a pleasure yacht there involved and a residence so is not a direct holding by that Court, but the above quoted language is certainly clear and convincing as to the views of that Court on this subject and its approval of the *Fagan* decision. The *Newberry* case (P-H Memo T.C., par. 45,077) does not seem to be directly in point as it involved inherited property, never occupied as a residence. It does, however, support the proposition that residential property not used by the taxpayers for residential purposes need only be offered for sale to permit deductions for expenses and depreciation, even though not offered for rent. Judge Arnold states that he sees no valid distinction between holding property for sale and holding it for rent, thus adding the weight of the opinion of another Tax Court judge to the five above mentioned.

In view of the foregoing heavy weight of judicial interpretation of the decisions of the Tax Court in favor of the position of Respondents in the case at bar, there seems little reason for this Court to give much weight to Petitioner's claims to the contrary. Here again, it seems appropriate to call particular attention to the Stipulation of Facts, numbers 5 through 12 [T. -16, 17], showing that Respondents here did a great deal more to establish the termination of the residential character of the Arcadia property than merely to move out of it and offer it for sale.

PART II.

DISCUSSION OF PETITIONER'S ARGUMENT.

A. Petitioner's General Argument.

The general argument by Petitioner, including most of the cases there cited, is covered in Part I, paragraphs A. through E. of the case for the taxpayers, which will not be repeated here except as portions of the taxpayers' argument bear particularly on points sought to be made by Petitioner.

Petitioner's argument first places heavy reliance on *United States v. Gilmore,* 372 U.S. 39, 44, 46, 83 S. Ct. 623, 9 L. Ed. 2d 570. That case is not in point, however, to the situation involved in the case at bar and, to the extent that it touches on such a situation as is herein involved, it supports the position of these taxpayers. It must be borne in mind that the *Gilmore* case disallows attorneys' fees in connection with a divorce, which were claimed as a deduction because if the divorce case had been lost, the taxpayer might have been severely crippled in the economic sense. The Court carefully distinguishes such a situation, where the expenses themselves are not related to the taxpayer's property and the effect on it would only be indirect and consequential, from those cases where the expenses are directly related to the property from which income is sought. This is entirely clear from the language in the second paragraph of Point I where the Court says, "For in context 'conservation of property' seems to refer to operations performed with respect to the property itself such as safeguarding or upkeep rather than a taxpayer's retention of ownership of it." In the case at bar, the expenses were the very type here specifically approved by the Supreme Court. They were for the

"upkeep" of the property and were not related to any effort of the taxpayer to retain his ownership of it against some adverse threat.

In later stating that the expense item involved must be one that has a business origin, the Court is clearly referring to the kind of activity which is directly connected with the purpose for which the property is being held and cannot be considered as limiting such deductions to activities which would constitute a trade or business. The Supreme Court uses the general word "business". This has many meanings. Webster's Third International Dictionary, Unabridged (1961), gives a half column to them. Among these 1 a.(3) reads, "an activity engaged in toward an immediate and specific end and usually extending over a limited period of time." The Court itself equates "business" purpose with "profit seeking purpose". Taxpayers' activities in repairing and maintaining their former home while trying to sell it come within this definition. As the Supreme Court notes, it was the purpose of Section 23(a)(2) of the 1939 Code (now Section 212(2)) to extend such deductions to cases where the search for profit was involved, as distinguished only from satisfying the needs of the taxpayer as a human, and those of his family, "who cannot deduct such consumption and related expenditures."

The Supreme Court was, no doubt, aware of the many cases above cited where expenses (and depreciation) were allowed in connection with a former home which was no longer being used to satisfy the creature needs of a taxpayer and his family. To overrule all of those cases, including those in which the former residence was offered for rent, would surely require some

more direct holding than that a distinction must be made between business and personal or family expenses. Once the taxpayers, in the case at bar, had established a new home, with no intention or probability of ever returning to the old one, the old one clearly no longer had any capacity for satisfying any personal or family desire of the taxpayers. The only purpose of their continued holding was to make a profit or minimize a loss upon its sale, which is obviously of a business rather than of a personal nature, as those purposes are distinguished by the Supreme Court in *Gilmore* (above) and in the many other cases cited on behalf of the taxpayers in Part I E. of this brief.

The most that can be said for Petitioner's claim, (on pages 11 and 12 of his brief), that the expense incurring activities of an investor be only as comprehensive as those which would also be allowable if incurred in a taxpayer's business, is that they should be for the same purposes and of the same kinds as are allowed as business deductions. There can be no doubt that a taxpayer in the business of buying and selling used boats would engage in the activities and expenditures necessary to see that they were well maintained, repaired and kept up in order to sell them to advantage. This is exactly the kind and quality of activity in which these taxpayers were engaging when they spent money for the same purposes on their former home, and for the same reason—to dispose of it, advantageously if possible. Allowance of these deductions surely involves no more favorable tax treatment than would be accorded the business man who did the same things.

Petitioner also cites the *Guffey* case in this Court, 339 F. 2d 759 (1964). The *Guffey* case is clearly not

in point as there the question was one of loss on sale of the former home, which is not here in issue. Numerous cases over a long period of years have made it clear that the rule is different where a loss is sought and that in such a case there must have been an actual conversion of the property to a business type of use in order to meet the requirement that the loss be incurred in a transaction entered into for profit under Section 165(c)(2) and its predecessor. *United States v. Kyle,* 242 F. 2d 825, and *Seletos v. Commissioner,* 254 F. 2d 794 are also sale cases, so not in point.

The Tax Court cases mentioned on Page 16 of Petitioner's brief are adequately covered in Part I E. of this brief. Nowhere in any of the above cases, or in the Statutes or Regulations here involved, has any authority been found for the statement by Petitioner at the top of Page 10 of his brief, that a former residence must be put to an investment *use* to justify these deductions. To so rule would give the word "held" the same effect in subsection 167(a)(2) of the Code as the very different word "used" in subsection 167(a)(1). This would substantially thwart the equalization purpose expressed by Congress for adding subsection 167(a)(2). (See Committee report quoted in Part I A. hereof.)

Petitioner then seeks to use Section 1034 as supporting his position by analogy. As that section is a separate relief section, adopted long after the sections here being considered and applying to an entirely different situation, it does not appear to have any bearing on the case at bar. In any event. Petitioner would, no doubt, vigorously protest any effort by a taxpayer to take advantage of the benefits of Section 1034 if the residential character of his former residence had

been definitely abandoned long before a new residence was acquired.

Starting on Page 19 of his brief, Petitioner then seems to confuse the transaction of disposing of the former residence with its status while being held by the taxpayers after they had abandoned it for residential purposes. Taxpayers vigorously disagree that the sale of a former home, no longer held for any personal or family purposes, is a personal transaction. Nevertheless, it is the period of the *holding* of the property, and expenses and depreciation during such holding, which is the subject of the Code sections here involved, and the question of whether, if ever, during his lifetime a taxpayer is able to dispose of his former home at a satisfactory price, or acquires a new home, should have no bearing on the allowance of expenses and depreciation while the former home is being held for sale, (except as evidence of the taxpayer's intent to terminate the home status of the former dwelling).

Petitioner's position is basically an effort to circumvent the holding of this Court in *Austin v. Commissioner,* 262 F. 2d 460 (1959), that the purpose for which property is acquired is only one factor in detering the purpose for which it is being held later on, and not a controlling one where other evidence overcomes it. He does this by attempting to attribute the personal nature of taxpayers' occupancy of the property while it was his home, to the period after that purpose had been abandoned and transferred to the taxpayers' new home. He seeks to accomplish this by using the device of claiming that the sale of the property was a personal transaction, instead of a primarily economic one, and substituting this alleged nature of the trans-

action for the statutory concept of the holding of the property. This clearly is contrary to the numerous cases above cited, including *Gilmore*. Counsel for the taxpayers is not aware of any instances in the Revenue Code where two actions by a taxpayer, which are as far separate in time and space as the construction by these taxpayers of their new home and the sale of their former one, are treated as constituting parts of one transaction. Petitioner's statement on Page 20 as to the "obvious" reason why Congress did mention the effect of a temporary rental of a home that is held for sale under Section 1034 and did not under Sections 167(a) and 212(2) seems entirely immaterial and erroneous because a temporary rental had already been held to be immaterial in cases such as the case at bar, (see *Robinson* (above) and *Neave* (above)), so Congress was only indicating that the same rule should apply under Section 1034. In Section 1034 Congress was merely giving equality of treatment to a taxpayer selling and buying, with one who exchanged his homes taxfree.

Starting on the middle of Page 20, Petitioner again seems to confuse the transaction aspect of the sale of a residence with the holding for sale of a former residence. In the event the old house is sold before the taxpayer moves, the sections here in question never apply. They do apply in any case where the taxpayer has abandoned the personal residential use of his former home before sale and this is so regardless of when, if ever, a new home is purchased (except as such a purchase may be considered evidence of abandonment of the residential character of the former home.) Thus, as hereinbefore stated, as long as the personal, living or family nature of the former home has terminated, these

sections come into play as the property no longer satisfies any personal or family need of the taxpayer.

At the middle of Page 21, Petitioner makes the unsupported statement that the real estate market was declining while the taxpayers were trying to sell their former home. It is much more likely that the depreciation of the property and the absentee status of the taxpayers brought about their acceptance of the reduced price.

Petitioner then seeks to equate a former residence, which the owners are trying to get their money out of, with personal assets such as pleasure boats, automobiles and home appliances. This contention is exactly what the Tax Court cases cited in Part I E. of this Argument, and the Fourth Circuit case there cited, effectively dispose of. In addition, where the Regulations except the taxpayer's home, they make no mention of a former home, and the provisions regarding disallowance of personal asset expenses make no mention of a former home (Regulation Section 1.212-1(h) and Section 1.167(a)-2).

So far as the removal of these taxpayers from the old residence of certain furnishings and planting is concerned, it was obviously because the taxpayers considered that these things would be of more value to them in connection with their new home than they would be able to get out of them by leaving them at the abandoned home and the removal of part of the planting would decrease maintenance expenses. This is entirely consistent with the wish of the taxpayers to obtain for themselves the most economic benefit from their old home, and is in no way inconsistent with their continued holding of it being for the purpose of obtaining

income (or minimizing a loss) by sale of it. Finally, when a homeowner is not able to sell his former home, simultaneously with the moving into of a new home, is just why that taxpayer is entitled to the deductions here allowed by the Tax Court. Any difference in treatment between that taxpayer and one who first sells his old house is due solely to the real difference in their positions,—the fact that the more fortunate taxpayer is relieved of the expense and does not suffer the depreciation that the taxpayers in the case at bar sustained. The taxpayers in this case were receiving none of the personal benefits of the continuing occupation of their old home which, while so occupied, takes the place of the expense and depreciation allowable while they were carrying it without any such personal benefit.

B. Petitioner's Special Argument Regarding Depreciation.

In Part II of his brief, Petitioner makes the bald statement that depreciation deductions are not allowable on assets held solely for sale. This statement runs contrary to all of the cases involving depreciation which have been cited in Part I E. of this brief. He seems to place this on the grounds that depreciation can only be taken on property which is "actively used in an investment activity". There is certainly no more active use made of a former residence that is held for rent as well as for sale, than there is of one that is held for sale only. Petitioner's claim would, therefore, result in striking down the allowance of depreciation on houses held for sale and for rent, as well as on those held for sale.

The Tax Court has consistently allowed depreciation where the property was held for rent and, in the case at bar, the Petitioner in the Tax Court and on Page 3 of his Petition for Review herein [T. -29], concedes that an offering for rent would have entitled these taxpayers to the depreciation deduction.

Petitioner also acquiesced in the Tax Court decision in *Mitchell,* 47 T.C. 120, decided as recently as November, 1966. In *Warner,* P-H Memo T.C., par. 47,144, the Tax Court mentions that the Petitioner there had stipulated to the allowance of expenses and depreciation while the taxpayers' former residence was idle. Footnote No. 3 to *Rogers,* P-H Memo T.C., par. 65,008 shows the same stipulation in that case as to depreciation. In view of this long continued acceptance by the Tax Court and the Petitioner, it seems far too late for the Petitioner to now assert that depreciation cannot be allowed on property held only for sale.

It should also be noted that the prohibition against depreciating inventory property does not extend to property held for sale but not considered inventory (Regulation Section 1.167(a)-(2).) Here would have been a logical place to so provide, if in fact depreciation were not intended to be allowable on non-inventory property held, nevertheless, for sale.

Considerable weight should also be given to the 1954 Code re-enactment by Congress, continuing the language of the 1942 Code on these points, after the Tax Court had decided *Robinson* and *Fagan* in favor of the taxpayers, with the Commissioner's stipulation in *Warner* also in the books. It is, of course, a well established rule that Congress is presumed to have accepted the previous interpretations by the Courts and

the Commissioner when it re-enacts a statute without change. *Biddle v. Commissioner,* 302 U.S. 573, 58 S. Ct. 379, 381, 82 L. Ed. 431.

On page 24 Petitioner cites a number of cases in support of his proposition that depreciation may not be taken on business property which is held only for sale. Some of these are based on the inventory concept of the property involved, several of them merely determine the proper date when depreciation should start, and all of them depend on the proposition that the property involved was used, or for use, in the taxpayer's trade or business. It should also be noted that all of them involved property which would either be used up, worn out, or sold in the course of the taxpayer's business operations. None of them is authority for the statement near the top of Page 25 that depreciation can be taken only on property which is actually used in an investment activity, where the Statute says "held".

To hold that all of the same rules applying under Regulation Section 1.167(a)-1 are applicable to subdivision 2 in the sense urged by Petitioner, would require that the phrase "held for the production of income" means substantially the same thing as "used in the trade or business". No cases are cited by Petitioner, nor found by taxpayers' counsel, where the meaning of the phrase "held for the production of income" is so restricted. Rather, it would appear that the limitations and restrictions applicable to both of these subsections refer to such things as the use of the property for personal or family purposes, or for pleasure, and the denial of such deductions for inventory property.

Petitioner then asserts that the function of depreciation is fundamentally inconsistent with allowing an in-

vestor to depreciate property held solely for sale. He cites *Massey Motors,* 364 U.S. 92, 80 S. Ct. 1581, 4 L. Ed. 2d 59 where the only issue was the length of time which should be used in computing the depreciation where the taxpayer's actual expected use in his business was less than the economic life of the property. The Court carefully points out (Point 1) that it is the ". . . type of asset, where the *experience of the taxpayers* clearly indicates a utilization of the asset for a substantially shorter period than its full economic life, that we are concerned with in these cases." (Emphasis supplied).

In *Detroit Edison Co. v. Commissioner,* 319 U.S. 98, 101; 63 S. Ct. 902; 87 L. Ed. 1286; the Supreme Court stated, "The end and purpose of it all (depreciation) is to approximate and reflect the consequences to the taxpayer of the subtle effects of *time* and use on the value of his capital assets." (Emphasis supplied).

United States v. Ludey, 274 U.S. 295, 47 S. Ct. 608, 71 L. Ed. 1054; involves only operating business property, and in *Burnet v. Harmel,* 287 U.S. 103, 53 S. Ct. 74, 77 L. Ed. 199, the issue of depreciation does not appear to be involved at all. None of these cases is authority for the disallowance of depreciation on property held for sale and the specific recognition of time as one factor in depreciation in *Detroit Edison Co. v. Commissioner* is some indication to the contrary.

Petitioner then states that where an asset is held only for ultimate sale, the gain or loss takes the place of depreciation. This is clearly not the case, as the gain or loss, where the property is not of an inventory character, is often capital in nature, whereas the deprecia-

tion is a deduction from ordinary income. The separation of the two concepts for tax purposes was firmly decided in 1966 by the Supreme Court in *Fribourg Navigation Co. v. Commissioner,* 383 U.S. 272, 277, 279, 281, 283, 86 S. Ct. 862; 15 L. Ed. 2d 751, Point I; where the Court allowed depreciation in the year of sale, saying, "By tying depreciation to sales price in this manner, the Commissioner has commingled two distinct and established concepts of tax accounting—depreciation of an asset through wear and tear or *gradual expiration* of its useful life and fluctuations in the value of that asset through changes in price levels or market values." (Emphasis supplied). *Fribourg* was followed in *The Motorlease Corporation v. U.S.,* 383 U.S. 573; 86 S. Ct. 1076; 16 L. Ed. 2d 106.

In the case of these taxpayers, it would be particularly unfair and unreasonable to deny the allowance for depreciation because their loss, when they sold the property, was not deductible even to the extent of the reduction in value between the time they abandoned the property as their home and the date when they finally sold it. (I.R.C. Sec. 165(c)(2); *Morgan v. Commissioner* (C.A. 5), 76 F. 2d 390.

Starting on Page 26, the Petitioner asserts that no depreciation deduction should be allowed because of the difficulty of arriving at estimated useful life and salvage value for property held only for sale, in spite of the fact that *all* useful life and salvage values are, at best, merely informed guesswork. He cites Section 1.167 (a)-1(a) and (g)-1 of the 1954 Code Regulations. In doing so, he seems to overlook entirely several points. First, these subsections are designed for situations like *Massey Motors* (above) where property used in business

operations may have a useful life to the taxpayer, which is less than its economic life; second, the imperative of Code Section 167(a) that depreciation *shall* be allowed on property held for the production of income, and Section 1.167(b)-0(a) authorizing any reasonable method and, third, the specific approval of the straight line method in the same Regulation Section 1.167(b)-1(a), which appears in the Appendix hereto. This provides that, in effect, the basis of the property, less its estimated salvage value, is deductible in estimated annual installments over the period of the estimated useful life of the property, that the straight line method may be used for any property subject to depreciation under Section 167, and *shall be used* where the taxpayer has not adopted a different acceptable method. In the case at bar, this is exactly what was done by the Petitioner in calculating the depreciation for the Tax Court judgment. The estimated useful life of the property was stipulated [T. -19], together with its basis at the date of its abandonment as taxpayers' home [T. -18, par. 20]. These stipulated findings of fact resulted in the determination of the amounts of the judgment, calculated and stipulated to by Petitioner. These calculations assumed that there was no salvage value. If Petitioner wished to question them, he should have done so in the Tax Court.

The straight line method of depreciation is, of course, the time-honored original method from which variations have been permitted by Statute and Regulation in various special situations. It should be particularly noted that the last mentioned subsection, appearing in the Appendix hereto, makes the annual deduction depend on the "useful life of the property". Nothing is

said here about the estimated useful life in the hands of the taxpayer, or in the taxpayer's business, or for the term for which the taxpayer expects to hold it. For cases where the Petitioner used the straight line method though an alternative under Regulation 1.167 (a)-1(b) and (c) was available, see the cases cited under issue II of the opinion of Justice Harlan in *Massey Motors* (above).

In the case of improvements on real property, none of the cases which Petitioner has cited, or that taxpayers' counsel found, indicates any necessity for the use of any other method than that set out in this last subsection.

So far as salvage value is concerned, it is a well-known fact of which this Court can, no doubt, take judicial notice, that a residence suffers little depreciation from actual use. Its depreciation is chiefly due to deterioration from the passage of time, from the work of the elements, rust, corrosion, termites, and rot—plus the obsolescence of changing styles of architecture, interior arrangement and built-in equipment, such as lighting and plumbing, and the changing character of neighborhoods. After these factors have terminated the useful life of a residence, far from having a salvage value, the necessity of tearing it down in order to make a suitable new use of the land is much more likely to cause a negative expense, rather than to yield a positive return from any salvage.

It might be further noted that this straight line method appears to have been that used in all of the depreciation cases cited in Part I E. of this brief, and the question has never been raised in any of them as to how long the taxpayer might retain the property or what its salvage value at the time of sale might be, even though in all those cases the property was offered for sale.

In view of the foregoing, taxpayers submit that Petitioner's entire argument directed specially to depreciation, starting on page 23 of his brief, is founded on a complete misconception of the nature of depreciation of a residence, the erroneous application thereto of the Law and the Regulations, and faulty reasoning, so should be discarded outright.

Conclusion.

The Supreme Court looks with disfavor on such a "sudden and unwarranted volte-face from a consistent administrative and judicial practice" as is represented by the cases and acquiescences above set out where a former residence is held only for sale, and the cases, acquiescences and administrative practices where offers to rent occurred, as is represented by the positions taken by the Petitioner before this Court. *Fribourg Navigation Co. v. Commissioner,* (above) issue III.

For the reasons stated generally in Part I hereof as to the issues of the allowance of expenses and depreciation, and in the case of the depreciation, also for the

reasons stated in Part II hereof, the taxpayers respectfully submit that the decision of the Tax Court was correct in all respects and, further, that even if some doubt should exist in the minds of the learned judges of this Court that the judgment of the Tax Court should be sustained on the basis of its findings of fact and the implications therefrom, and its application thereto, of the applicable law.

Respectfully submitted,

DANA C. SMITH,
Counsel for Respondents.

Certificate.

I certify that in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

DANA C. SMITH

APPENDIX.

Internal Revenue Code of 1954:

SEC. 167. DEPRECIATION.

(a) *General Rule.*—There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

* * *

(26 U.S.C., 1964 ed., Sec. 167.)

SEC. 212. EXPENSES FOR PRODUCTION OF INCOME.

In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year—

(1) for the production or collection of income;

(2) for the management, conservation, or maintenance of property held for the production of income; or

(3) in connection with the determination, collection, or refund of any tax.

(26 U.S.C., 1964 ed., Sec. 212.)

SEC. 262. PERSONAL, LIVING, AND FAMILY EXPENSES.

Except as otherwise expressly provided in this chapter, no deduction shall be allowed for personal, living, or family expenses.

(26 U.S.C., 1964 ed., Sec. 262.)

SEC. 165. LOSSES.

* * *

(c) *Limitation of Losses of Individuals.*—In the case of an individual, the deduction under subsection (a) shall be limited to—

(1) losses incurred in a trade or business;

(2) losses incurred in any transaction entered into for profit, though not connected with a trade or business; and

* * *

SEC. 62. ADJUSTED GROSS INCOME DEFINED.

* * *

(5) *Deductions attributable to rents and royalties*—The deductions allowed by part VI (sec. 161 and following), by section 212 (relating to expenses for production of income), and by section 611 (relating to depletion) which are attributable to property held for the production of rents or royalties

* * *

SEC. 1034. SALE OR EXCHANGE OF RESIDENCE.

(a) *Nonrecognition of Gain.*—If property (in this section called "old residence") used by the taxpayer as his principal residence is sold by him after December 31, 1953, and, within a period beginning 1 year before the date of such sale and ending 1 year after such date, property (in this section called "new residence") is purchased and used by the taxpayer as his principal residence, gain (if any) from such sale shall be recognized

only to the extent that the taxpayer's adjusted sales price (as defined in subsection (b) of the old residence exceeds the taxpayer's cost of purchasing the new residence.

* * *

Treasury Regulations on Income Tax (1954 Code):

§1.167(b)-0 *Methods of computing depreciation.*

(a) *In general.*—Any reasonable and consistently applied method of computing depreciation may be used or continued in use under section 167. Regardless of the method used in computing depreciation, deductions for depreciation shall not exceed such amounts as may be necessary to recover the unrecovered cost or other basis less salvage during the remaining useful life of the property. The reasonableness of any claim for depreciation shall be determined upon the basis of conditions known to exist at the end of the period for which the return is made. It is the responsibility of the taxpayer to establish the reasonableness of the deduction for depreciation claimed. Generally, depreciation deductions so claimed will be changed only where there is a clear and convincing basis for a change.

* * *

§1.167(b)-1 *Straight line method.*

(a) *Application of method.*—Under the straight line method the cost or other basis of the property less its estimated salvage value is deductible in equal annual amounts over the period of the estimated useful life of the property. The allowance for depreciation for the taxable year is determined

by dividing the adjusted basis of the property at the beginning of the taxable year, less salvage value, by the remaining useful life of the property at such time. For convenience, the allowance so determined may be reduced to a percentage or fraction. The straight line method may be used in determining a reasonable allowance for depreciation for any property which is subject to depreciation under section 167 and it shall be used in all cases where the taxpayer has not adopted a different acceptable method with respect to such property.

* * *

§1.212-1 *Nontrade or nonbusiness expenses.*

* * *

(b) The term "income" for the purpose of section 212 includes not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years; and is not confined to recurring income but applies as well to gains from the disposition of property. For example, if defaulted bonds, the interest from which if received would be includible in income, are purchased with the expectation of realizing capital gain on their resale, even though no current yield thereon is anticipated, ordinary and necessary expenses thereafter paid or incurred in connection with such bonds are deductible. Similarly, ordinary and necessary expenses paid or incurred in the management, conservation, or maintenance of a building devoted to rental purposes are deductible notwithstanding that there is actually no income there-

from in the taxable year, and regardless of the manner in which or the purpose for which the property in question was acquired. Expenses paid or incurred in managing, conserving, or maintaining property held for investment may be deductible under section 212 even though the property is not currently productive and there is no likelihood that the property will be sold at a profit or will otherwise be productive of income and even though the property is held merely to minimize a loss with respect thereto.

* * *